

Benzie County Central School District

FINANCIAL STATEMENTS
AND REPORT OF INDEPENDENT
CERTIFIED PUBLIC ACCOUNTANTS

June 30, 2006

CONTENTS

	<u>Page</u>
MANAGEMENT'S DISCUSSION AND ANALYSIS.....	i
REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS.....	2
FINANCIAL STATEMENTS	
STATEMENT OF NET ASSETS.....	4
STATEMENT OF ACTIVITIES.....	5
BALANCE SHEET - GOVERNMENTAL FUNDS.....	6
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES - GOVERNMENTAL FUNDS.....	7
RECONCILIATION OF THE GOVERNMENTAL FUNDS STATEMENT OF REVENUE, EXPENDITURES AND CHANGES IN FUND BALANCES WITH THE DISTRICT-WIDE STATEMENT OF ACTIVITIES.....	8
STATEMENT OF FIDUCIARY NET ASSETS.....	9
NOTES TO FINANCIAL STATEMENTS.....	10
REQUIRED SUPPLEMENTARY INFORMATION	
BUDGETARY COMPARISON SCHEDULE FOR THE GENERAL FUND.....	23
COMBINING FINANCIAL STATEMENTS OF NON-MAJOR GOVERNMENTAL FUNDS	
BALANCE SHEET.....	24
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES.....	26
FEDERAL PROGRAMS	
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS.....	28
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS.....	30
REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENTAL AUDITING STANDARDS.....	31
REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133.....	32
SCHEDULE OF FINDINGS AND QUESTIONED COSTS.....	34

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of Benzie County Central Schools (BCCS) annual financial report presents a discussion and analysis of the District's financial performance during the fiscal year that ended on June 30, 2006. It is to read it in conjunction with the transmittal letter at the front of this report and the District's financial statements, which immediately follow this section.

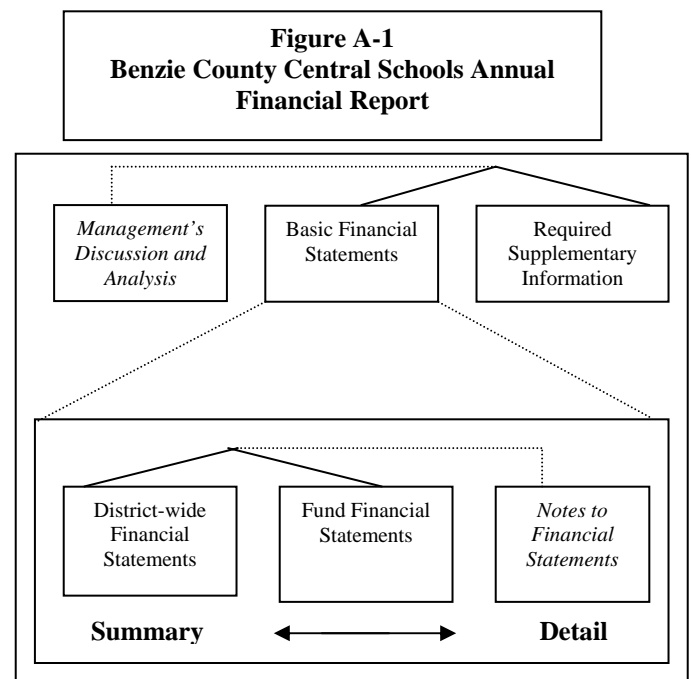
FINANCIAL HIGHLIGHTS

- The District's financial status remained somewhat stable compared to last school year, there were no reductions to foundation grant or categorical aid, and enrollment increased only slightly. However, though revenue sources remain constant, or decrease in some instances, major expenditures continue to increase.
- Foundation grant of \$6,875/pupil remained constant throughout the year (no reductions).
- Enrollment increased by only 14, or 0.7%, compared to June 2005.
 - 6/30/05 = 2,030 – 6/30/06 = 2,044
- The District's contribution rate for employee retirement increased by 1.47%, from 14.87% in 2004/05 to 16.34%.
- Health insurance costs increased by an average of 5% in 2005/06 compared to insurance rates in 2004/05 due to a negotiated change from MESSA Super Care I to MESSA Choices II, a PPO plan versus a traditional health plan.
- Energy costs continued to increase. The natural gas expense increased 18% from 04/05, from \$185,852/year to \$220,473/year. Diesel fuel expense increased 39% from 04/05, from \$176,782/year to \$246,501/year.

OVERVIEW OF THE FINANCIAL STATEMENTS

This annual report consists of three parts – management's discussion and analysis (this section), the basic financial statements and required supplementary information. The basic financial statements include two kinds of statements that present different views of the District:

- The first two statements are *district-wide financial statements* that provide both *short-term* and *long-term* information about the District's *overall* financial status.
- The remaining statements are *fund financial statements* that focus on *individual parts* of the District, reporting the District's operations *in more detail* than the district-wide statements.
- The *governmental funds* statements tell how *basic* services like regular and special education were financed in the *short-term* as well as what remains for future spending.
- *Fiduciary funds* statements provide information about the financial relationships in which the District acts solely as a *trustee or agent* for the benefit of others.



The financial statements also include *notes* that explain some of the information in the statements and provide more detailed data. The statements are followed by a section of *required supplementary information* that further explains and supports the financial statements with a comparison of the District’s budget for the year. Figure A-1 on the previous page shows how the various parts of this annual report are arranged and related to one another.

Figure A-2 Major Features of District-Wide and Fund Financial Statements			
	District-wide Statements	Fund Financial Statements	
		Governmental Funds	Fiduciary Funds
Scope	Entire district (except fiduciary funds)	The activities of the district that are not proprietary or fiduciary, such as special education and building maintenance.	Instances in which the district administers resources on behalf of someone else, such as scholarship programs and student activities monies
Required financial statements	* Statement of net assets * Statement of activities	* Balance sheet * Statement of revenues, expenditures and changes in fund balances	* Statement of fiduciary net assets * Statement of changes in fiduciary net assets
Accounting basis and measurement focus	Accrual accounting and economic resources focus	Modified accrual accounting and current financial resources focus	Accrual accounting and economic resources focus
Type of asset/liability information	All assets and liabilities, both financial and capital, short-term and long-term	Generally assets expected to be used up and liabilities that come due during the year or soon thereafter; no capital assets or long-term liabilities included	All assets and liabilities, both short-term and long-term, ABC's funds do not currently contain capital assets, although they can
Type of inflow/outflow information	All revenues and expenses during year, regardless of when cash is received or paid	Revenues for which cash is received during or soon after the end of the year, expenditures when goods or services have been received and the related liability is due and payable	All additions and deductions during the year, regardless of when cash is received or paid

Figure A-2 summarized the major features of the District’s financial statements, including the portion of the District’s activities they cover and the types of information they contain. The remainder of this overview section of management’s discussion and analysis highlights the structure and contents of each of the statements.

DISTRICT-WIDE STATEMENTS

The district-wide statements report information about the District as a whole using accounting methods similar to those used by private-sector companies. The statements of net assets includes *all* of the District’s assets and liabilities. All of the current year’s revenues and expenses are accounted for in the statement of activities regardless of when cash is received or paid.

The two district-wide statements report the District’s *net assets* and how they have changed. Net assets – the difference between the District’s assets and liabilities – are one way to measure the District’s financial health or *position*.

- Over time, increases or decreases in the District’s net assets are an indicator of whether its financial position is improving or deteriorating, respectively.
- To assess the overall health of the District, consideration must be given to additional nonfinancial factors such as changes in the District’s property tax base and the condition of school buildings and other facilities.

In the district-wide financial statements, the District’s activities include:

- *Governmental activities* – Most of the District’s basic services are included here, such as regular and special education, transportation and administration. Property taxes and state formula aid finance most of these activities.

FUND FINANCIAL STATEMENTS

The fund financial statements provide more detailed information about the District's *funds*, focusing on its most significant or "major" funds – not the District as a whole. Funds are accounting devices the District uses to keep track of specific sources of funding and spending on particular programs:

- Some funds are required by State law and by bond covenants.
- The District establishes other funds to control and manage money for particular purposes (repayment of long-term debts) or to show that it is properly using certain revenues (like school lunch and athletics).

The District has two kinds of funds:

- *Governmental funds* – Most of the District's basic services are included in governmental funds, which generally focus on (1) how *cash and other financial assets* that can readily be converted to cash flow in and out and (2) the balances left at year-end that are available for spending. Consequently, the governmental funds statements provide a detailed *short-term* view that helps determine whether there are more or fewer financial resources that can be spent in the near future to finance the District's programs. Because this information does not encompass the additional long-term focus of the district-wide statements, additional information is provided with the governmental funds statements that explains the relationship (or differences) between them.
- *Fiduciary funds* – The District is the trustee, or *fiduciary*, for assets that belong to others, such as the scholarship fund and the student activities funds. The District is responsible for ensuring that the assets reported in these funds are used only for their intended purposes and by those to whom the assets belong. We exclude these activities from the district-wide financial statements because the District cannot use these assets to finance its operations.

FINANCIAL ANALYSIS OF THE DISTRICT AS A WHOLE

Net assets – The District's *combined* net assets were less on June 30, 2006, than they were the year before – decreasing by \$261,076, to \$1,993,435.

The District's financial position is the product of several independent factors. Although revenues did increase compared to last year, expenses continued to exceed incoming revenues. Increases in salary and benefits continue to climb; however, there were large increases in the cost of natural gas and diesel fuel during the 2005/06 school year that were beyond the control of the District.

Table A-3
BCCS's Net Assets

	2005	2006
Current and other assets	\$ 4,032,377	\$ 3,522,922
Capital assets	<u>11,033,357</u>	<u>10,687,078</u>
Total assets	<u>15,065,734</u>	<u>14,210,000</u>
Long-term debt outstanding	10,622,117	10,157,164
Other liabilities	<u>2,189,106</u>	<u>2,059,401</u>
Total liabilities	<u>12,811,223</u>	<u>12,216,565</u>
Net assets		
Invested in capital assets, net of related debt	164,441	282,195
Restricted	152,665	281,905
Unrestricted	<u>1,937,405</u>	<u>1,429,335</u>
Total net assets	<u>\$ 2,254,511</u>	<u>\$ 1,993,435</u>

Table A-4
Changes in BCCS's Net Assets

Revenues		
Property Taxes	2005	2006
Levied for general purposes	\$ 4,953,781	\$ 5,369,277
Levied for debt service	883,932	894,100
State school aid - unrestricted	8,725,177	8,329,538
Grants and contributions not restricted for a specific program	238,340	293,073
Charges for services	312,594	333,207
Operating grants and contributions	1,561,266	2,365,289
Capital grants and contributions	23,475	101,269
Investment and other	<u>22,153</u>	<u>60,618</u>
Total revenues	<u>16,720,718</u>	<u>17,746,371</u>
Expenses		
Instruction	9,444,966	10,066,175
Support services	5,521,258	5,910,211
Community services	53,887	57,686
Food services	755,069	807,336
Athletics	265,183	261,548
Other	43,756	11,153
Debt Service		
Interest	578,821	430,803
Depreciation	<u>500,867</u>	<u>462,535</u>
Total expenses	17,163,807	18,007,447
Decrease in net assets	<u><u>\$ (443,089)</u></u>	<u><u>\$ (261,076)</u></u>

District Governmental Activities

In order to provide financial stability, the District continued sound financial planning and personnel management for the 2005/06 School Year.

- Teacher retiring or resigning the district, are replaced only if enrollments dictate the need for increased instruction.
- Teachers who retired or resigned, were replaced by those at entry level or lower pay scales than the incumbents in 2005/06.
- Grant funded programs are totally dependent upon dollars received. If dollars coming in from the grant decrease, expenses are decreased accordingly.
- The District continues to assess enrollment and has established a baseline classroom size of not less than 15 students.

FINANCIAL ANALYSIS OF THE DISTRICT'S FUNDS

The financial performance of the District as a whole is reflected in its governmental funds. As the District completed the year, its governmental funds reported a fund balance of \$1,705,078, or \$461,003 below last year's ending fund balances of \$2,166,081.

General Fund Budgetary Highlights

Over the course of the year, the District revises the annual operating budget quarterly. The District begins the school year the last week of August, before the State's fiscal year begins in October. Therefore, budget assumptions made by the District earlier in the year may not materialize when the State implements the education budget.

Changes are made to final student enrollment counts, staffing assignments and changes in grant funding since the original budget was adopted.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

Depreciable assets for the 2005/06 school year totaled \$17,754,690. Due to dwindling resources, the District was unable to invest as much in new busses and new equipment as in previous years. The increased investment of only \$10,518 from 2005 to 2006 is quite a bit less than the increase from 2004 to 2005 that totaled \$213,222. The sale of three buses from the district's aging bus fleet contributed the decrease in bus/vehicle assets.

	2005	2006
Buildings & improvements	\$ 15,173,102	\$ 15,173,102
Furniture & equipment	878,870	921,001
Buses & vehicles	1,692,200	1,660,587
Total	<u>\$ 17,744,172</u>	<u>\$ 17,754,690</u>
Increase		<u>\$ 10,518</u>

Long-term Debt

At year-end the District had \$10,681,217 in general obligation bonds and \$220,896 in accumulated leave liability. (More detailed information about the District's long-term liabilities is presented in Note G to the financial statements.)

Table A-6		
BCCS's Outstanding Long-Term Debt		
	2005	2006
General obligation debts		
(financed with property taxes)	\$ 11,174,977	\$ 10,681,217
Unaccreted Premium	89,975	80,459
Unamortized refinancing cost	(384,595)	(356,793)
Accumulated Sick & Vacation Leave	217,235	220,896
Total	<u>\$ 11,097,592</u>	<u>\$ 10,625,779</u>

FACTORS BEARING ON THE DISTRICT'S FUTURE

At the time these financial statements were prepared and audited, the District was aware of four existing circumstances that could significantly affect its financial health in the future:

- The 2006-2007 foundation allowance has been proposed by the State of Michigan to increase to \$7,085/pupil, a 3% increase from 05/06.
- The *preliminary blended* student count for the 2006/07 school year reflects an decrease of 10 students from the original June, 2006 estimate. The official count will not occur until after this audit is published.
- Health insurance costs continue to rise in spite of the insurance conversion to a new PPO health insurance plan called MESSA Choices II for teachers and support staff. The MESSA Choices II rate increased 9.9% from 05/06 to 06/07.
- The district's retirement contribution rate increased to 17.74% compared to the 05/06 contribution rate of 16.34%.

CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers and investors and creditors with a general overview of the District's finances and to demonstrate the District's accountability for the money it receives. If you have questions about this report or need additional information, contact the Central Business Office, Benzie County Central Schools, 9222 Homestead Rd, Benzonia MI 49616.



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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Education
Benzie County Central School District

We have audited the accompanying financial statements of governmental activities, each major fund and the aggregate remaining fund information of ***Benzie County Central School District*** (the "School District") as of and for the year ended June 30, 2006, which collectively comprise the School District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the School District's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material aspects, the respective financial position of the governmental activities, each major fund and the aggregate remaining fund information of the Benzie County Central School District as of June 30, 2006, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 3, 2006, on our consideration of the School District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in conjunction with this report in considering the results of our audit.

The management's discussion and analysis on pages i - vi and the budgetary comparison information on page 23, are not a required part of the basic financial statements, but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the School District's basic financial statements. The combining non-major fund financial statements are presented for purposes of additional analysis and are not a required part of the basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*, and is also not a required part of the basic financial statements of the School District. The combining non-major fund financial statements and the Schedule of Expenditures of Federal Awards have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Dennis, Gartland & Niergarth

August 3, 2006

Benzie County Central School District

STATEMENT OF NET ASSETS

June 30, 2006

	Governmental Activities
ASSETS	
Current assets	
Cash and cash equivalents	\$ 1,496,575
Taxes receivable	1,933,220
Inventory	<u>93,127</u>
Total current assets	3,522,922
Capital assets, net of accumulated depreciation	<u>10,687,078</u>
Total assets	<u><u>\$ 14,210,000</u></u>
LIABILITIES AND NET ASSETS	
LIABILITIES	
Current liabilities	
Accounts payable	\$ 68,125
State aid anticipation note payable	247,892
Salaries payable and related expenses	1,172,546
Accrued expenses	102,223
Current portion of long-term liabilities	<u>468,615</u>
Total current liabilities	2,059,401
Non-current portion of long-term obligations	<u>10,157,164</u>
Total liabilities	<u>12,216,565</u>
NET ASSETS	
Invested in capital assets, net of related debt	282,195
Restricted for	
Debt Service	222,082
School-based activities	4,976
Way-to-grow	20,035
Special education	34,812
Unrestricted	<u>1,429,335</u>
Total net assets	<u>1,993,435</u>
Total liabilities and net assets	<u><u>\$ 14,210,000</u></u>

The accompanying notes are an integral part of these financial statements.

Benzie County Central School District

STATEMENT OF ACTIVITIES

Year Ended June 30, 2006

Functions/Program	Expenses	Program Revenues			Net (Expense)/ Revenue and Changes in Net Assets
		Charges For Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities
Governmental activities					
Instruction	\$ 10,066,175	\$ -	\$ 1,959,946	\$ -	\$ (8,106,229)
Supporting Services	5,910,211	-	-	-	(5,910,211)
Community Services	57,686	-	-	-	(57,686)
Food Service	807,336	263,239	405,343	-	(138,754)
Athletic	261,548	69,968	-	-	(191,580)
Other	11,153	-	-	101,269	90,116
Interest on long-term debt	430,803	-	-	-	(430,803)
Depreciation-unallocated	462,535	-	-	-	(462,535)
Total governmental activities	<u>\$ 18,007,447</u>	<u>\$ 333,207</u>	<u>\$ 2,365,289</u>	<u>\$ 101,269</u>	<u>(15,207,682)</u>
General purpose revenues					
Property taxes					
Levied for general purposes					5,369,277
Levied for debt service					894,100
State school aid - unrestricted					8,329,538
Grants and contributions not restricted to specific program					293,073
Investment and other					<u>60,618</u>
Total general purpose revenue					<u>14,946,606</u>
Change in net assets					(261,076)
Net assets, beginning of year					<u>2,254,511</u>
Net assets, end of year					<u>\$ 1,993,435</u>

-5- The accompanying notes are an integral part of these financial statements.

Benzie County Central School District

BALANCE SHEET - GOVERNMENTAL FUNDS

June 30, 2006

	General Fund	Other Governmental Funds	Total Governmental Funds
ASSETS			
Cash and cash equivalents	\$ 1,057,997	\$ 438,578	\$ 1,496,575
Taxes receivable	-	444	444
Accounts receivable	1,926,749	6,027	1,932,776
Due from other funds	126,569	6,254	132,823
Inventory	85,439	7,688	93,127
	<u>3,196,754</u>	<u>458,991</u>	<u>3,655,745</u>
Total assets	<u>\$ 3,196,754</u>	<u>\$ 458,991</u>	<u>\$ 3,655,745</u>
LIABILITIES AND FUND BALANCES			
LIABILITIES			
Accounts payable and accrued expenses	\$ 1,237,530	\$ 31,284	\$ 1,268,814
Due to other funds	6,254	126,569	132,823
State aid anticipation note payable	247,892	-	247,892
	<u>1,491,676</u>	<u>157,853</u>	<u>1,649,529</u>
Total liabilities	<u>1,491,676</u>	<u>157,853</u>	<u>1,649,529</u>
FUND BALANCES			
Reserved for debt retirement	-	296,162	296,162
Reserved for inventory	85,439	-	85,439
Reserved for Food Service	-	4,976	4,976
Reserved for Way-to-grow program	20,035	-	20,035
Reserved for special education	34,812	-	34,812
Unreserved and undesignated			
Reported in General Fund	1,564,792	-	1,564,792
	<u>1,705,078</u>	<u>301,138</u>	<u>2,006,216</u>
Total fund balances	<u>1,705,078</u>	<u>301,138</u>	<u>2,006,216</u>
Total liabilities and fund balances	<u>\$ 3,196,754</u>	<u>\$ 458,991</u>	

Reconciliation of Governmental Fund Balances to District-Wide Government Activities Net Assets

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and, therefore, are not reported as assets in governmental funds. The cost of the assets is \$17,808,131 and the accumulated depreciation is \$(7,121,053).

10,687,078

Long-term liabilities, including bonds payable, are not due and payable in the current period and, therefore, are not reported as liabilities in the funds. Long-term liabilities at year-end consist of:

Bonds payable	\$ 10,681,217	
Accrued interest on bonds	74,080	
Unamortized bond premium	80,459	
Unamortized refinancing costs	(356,793)	
Accumulated leave liability	220,896	(10,699,859)
	<u>220,896</u>	<u>(10,699,859)</u>

Total net assets - governmental activities

\$ 1,993,435

The accompanying notes are an integral part of these financial statements.

Benzie County Central School District

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES - GOVERNMENTAL FUNDS

Year Ended June 30, 2006

	General Fund	Other Governmental Funds	Total Governmental Funds
Revenues			
Property taxes	\$ 5,369,277	\$ 894,100	\$ 6,263,377
Interest	49,172	8,181	57,353
State revenues	9,270,160	134,224	9,404,384
Federal revenues	616,752	348,912	965,664
Other	719,120	336,473	1,055,593
	<u>16,024,481</u>	<u>1,721,890</u>	<u>17,746,371</u>
Total revenues			
Expenditures			
Instruction	9,988,536	-	9,988,536
Supporting Services	5,910,211	-	5,910,211
Community Services	57,686	-	57,686
Food Service	-	785,299	785,299
Athletic	-	228,522	228,522
Other	11,153	-	11,153
Debt Service			
Principal	-	493,760	493,760
Interest	-	478,993	478,993
Capital outlay	190,234	55,063	245,297
	<u>16,157,820</u>	<u>2,041,637</u>	<u>18,199,457</u>
Total expenditures			
REVENUES UNDER EXPENDITURES	<u>(133,339)</u>	<u>(319,747)</u>	<u>(453,086)</u>
Other financing sources (uses)			
Operating transfers in	-	518,093	518,093
Operating transfers out	(327,664)	(190,429)	(518,093)
	<u>(327,664)</u>	<u>327,664</u>	<u>-</u>
Total other financing sources (uses)			
REVENUE OVER (UNDER) EXPENDITURES AND OTHER FINANCING SOURCES (USES)	(461,003)	7,917	(453,086)
Fund balance, beginning of year	<u>2,166,081</u>	<u>293,221</u>	<u>2,459,302</u>
Fund balance, end of year	<u><u>\$ 1,705,078</u></u>	<u><u>\$ 301,138</u></u>	<u><u>\$ 2,006,216</u></u>

The accompanying notes are an integral part of these financial statements.

Benzie County Central School District

RECONCILIATION OF THE GOVERNMENTAL FUNDS STATEMENT OF REVENUE, EXPENDITURES AND CHANGES IN FUND BALANCES WITH THE DISTRICT-WIDE STATEMENT OF ACTIVITIES

Year Ended June 30, 2006

Total Net Change in Fund Balances - Governmental Funds \$ (453,086)

Amounts reported for governmental activities in the statement of activities are different because:

Capital outlays to purchase or build capital assets are reported in the governmental funds as expenditures. However, costs that meet the capitalization policy are shown in the statement of net assets and allocated over their estimated useful lives as annual depreciation expenses in the statement of activities. This is the amount by which capital outlays exceeds depreciation in the period.

Capital outlays	\$ 116,256	
Depreciation expense	<u>(462,535)</u>	(346,279)

In the statement of activities, certain operating expenses - compensated absences (vacations and sick leave) - are measured by the amounts earned during the year. In the governmental funds, however, expenditures for these items are measured by the amount of financial resources used (essentially, the amounts actually paid). This year, sick time earned was greater than the amounts paid by \$3,661. (3,661)

Repayment of bond principal is an expenditure or other financing use in the governmental funds, but reduces long-term liabilities in the statement of net assets and does not affect the statement of activities. 493,760

Net amortization of bond premium, issuance costs and difference between the reacquisition price and net carrying amount of defeased debt. (18,286)

Interest on long-term debt in the statement of activities differs from the amount reported in the governmental funds because interest is recorded as an expenditure in the funds when it is due, and thus requires the use of current financial resources. In the statement of activities, however, interest expense is recognized as the interest accrues, regardless of when it is due. The interest reported in the statement of activities is the net result of the decrease in accrued interest on bonds payable. 66,476

Changes in Net Assets of Governmental Activities \$ (261,076)

Benzie County Central School District

STATEMENT OF FIDUCIARY NET ASSETS

June 30, 2006

	<u>Agency Funds</u>
ASSETS	
Cash and cash equivalents	<u>\$ 36,521</u>
LIABILITIES	
Due to student groups	<u>\$ 36,521</u>

The accompanying notes are an integral part of these financial statements.

Benzie County Central School District

NOTES TO FINANCIAL STATEMENTS

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Introduction

Benzie County Central School District (the "School District") is a Michigan public school district consisting of four elementary schools, a middle school and a high school. The School District primarily serves the Benzonia, Lake Ann, Honor and Crystal Lake communities. As of June 30, 2006, the School District employs 108 professional staff and 124 non-professional staff and has 2044 students enrolled within its School District.

The accounting policies of the School District conform to generally accepted accounting principles as applicable to governments. The School District is considered to be a local government unit.

The accounting and reporting framework and the more significant accounting principles and practices of the School District are discussed in subsequent sections of this note. The remainder of the notes are organized to provide explanations, including required disclosures, of the School District's financial activities for the fiscal year ended June 30, 2006.

The Financial Reporting Entity

Benzie County Central School District's Board of Education (the "Board") is the basic level of government which has oversight responsibility and control over all activities related to the public school education. The Board receives funding from local, State and Federal government sources and must comply with the concomitant requirements of these funding source entities. However, the Board is not included in any other governmental "reporting entity," as defined in Governmental Accounting Standards Board ("GASB") Statement No. 14, since Board members are elected by the public and have decision-making authority to levy taxes, the power to designate management, the ability to significantly influence operations and primary accountability for fiscal matters. In addition, under the criteria of the GASB pronouncement, student, parent and teacher organizations are not included, except to the extent that the School District holds assets in the capacity of an agent.

Government-Wide and Fund Financial Statements

Government-Wide Financial Statements

The statement of net assets and statement of activities display information about the School District as a whole, except for its fiduciary activities. Individual funds are not displayed but the statements distinguish governmental activities, generally supported by taxes and School District general revenues.

NOTES TO FINANCIAL STATEMENTS - Continued

The statement of activities reports the expenses of a given function offset by program revenues directly connected with the functional program. A function is an assembly of similar activities and may include portions of a fund or summarize more than one fund to capture the expenses and program revenues associated with a distinct functional activity. Program revenues include: (1) charges for services which report fees, fines and forfeitures, and other charges to users of the School District's services; (2) operating grants and contributions which finance annual operating activities including restricted investment income; and (3) capital grants and contributions which fund the acquisition, construction or rehabilitation of capital assets. These revenues are subject to externally imposed restrictions to these program uses. Taxes and other revenue sources not properly included with program revenues are reported as general revenues.

Fund Financial Statements

The balance sheet and statement of revenues, expenditures and changes in fund balances (i.e., fund financial statements) for the School District's governmental funds are presented after the government-wide statements. These statements display information about major funds individually and non-major funds in the aggregate for governmental funds. Major funds are generally those that represent 10% or more of governmental fund assets, liabilities, revenues or expenditures.

Measurement Focus, Basis of Accounting and Financial Statement Presentation

The financial statements of the School District are prepared in accordance with generally accepted accounting principles ("GAAP"). The School District's reporting entity applies all relevant Governmental Accounting Standards Board ("GASB") pronouncements and applicable Financial Accounting Standards Board ("FASB") pronouncements and Accounting Principles Board ("APB") opinions issued on or before November 30, 1989, unless they conflict with GASB pronouncements. The School District's reporting entity does not apply FASB pronouncements or APB opinions issued after November 30, 1989.

The government-wide statements report using the economic resource measurement focus and the accrual basis of accounting generally including the reclassification or elimination of internal activity (between or within funds). Reimbursements are reported as reductions to expenses. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized in the year for which they are levied, while grants are recognized when grantor eligibility requirements are met.

Governmental fund financial statements report using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized when they are both measurable and available. Available means collectible within the current period or soon enough thereafter to pay current liabilities. The School District considers revenues to be available if they are collected within 60 days of the end of the fiscal year. Expenditures are recorded when the related fund liability is incurred, except for general obligation bond principal and interest which are reported as expenditures in the year due.

Major revenue sources susceptible to accrual include property taxes, intergovernmental revenues and investment income. In general, other revenues are recognized when cash is received.

NOTES TO FINANCIAL STATEMENTS - Continued

Fund Types and Major Funds

Activities in Major Funds

The General Fund is the general operating fund of the School District. It is used to account for all financial resources except those required to be accounted for in another fund.

Other Governmental Funds

Special Revenue Funds are used to account for the proceeds of specific revenue sources that are restricted to expenditures for specified purposes. The School Service Funds are Special Revenue Funds that segregate, for administrative purposes, the transactions of a particular activity from regular revenue and expenditure accounts. The School District maintains full control of these funds. The Special Revenue Funds maintained by the School District are the Athletic Fund and Food Service Fund.

The Debt Retirement Funds are used to account for the accumulation of resources for, and the payment of, bond principal, interest and related costs.

Fiduciary Funds

Fiduciary Funds are used to account for assets held by the School District in a trustee capacity or as an agent. Fiduciary Fund net assets and results of operations are not included in the government-wide statements. Agency Funds are custodial in nature (assets equal liabilities) and do not involve measurement of results of operations.

Cash and Equivalents

The School District reporting entity considers highly liquid investments (including restricted assets) with an original maturity of three months or less when purchased to be cash equivalents.

Inventories

Inventories in governmental funds consist of expendable supplies held for consumption stated on a first-in, first-out basis. They are reported at cost, which is recorded as an expenditure at the time individual inventory items are used.

Capital Assets

Capital assets are recorded at cost or, if donated, the fair value at the time of donation. Capital assets are depreciated over their estimated useful lives ranging from 5 to 50 years. The School District generally capitalizes assets with costs of \$5,000 or more as purchase and construction outlays occur. No depreciation is recorded on land or construction-in-process. Expenditures for major renewals and betterments that extend the useful lives of the capital assets are capitalized. Expenditures for maintenance and repairs are charged to current expenditures as incurred. Depreciation is computed using the straight-line method. When capital assets are disposed, the cost and applicable accumulated depreciation are removed from the respective accounts and the resulting gain or loss is recorded in operations.

NOTES TO FINANCIAL STATEMENTS - Continued

Estimated useful lives, in years, for depreciable assets are as follows:

Buildings	50 years
Improvements, other than buildings	20 years
Buses and vehicles	10 years
Furniture and equipment	5 years

Long-term Debt, Deferred Debt Expense and Bond Discounts/Premiums

In the government-wide financial statements, outstanding debt is reported as liabilities. Bond issuance costs, bond discounts or premiums, and the difference between the reacquisition price and the net carrying value of refunded debt are capitalized and amortized over the terms of the respective bonds using a method that approximates the interest method.

The governmental fund financial statements recognize the proceeds of debt and premiums as other financing sources of the current period. Issuance costs are reported as expenditures.

Fund Equity

The governmental fund financial statements report reserved fund balance for amounts not available for appropriation or legally restricted for specified purposes. Designations of fund balance represent tentative management plans that are subject to change.

Program Revenues

Program revenues derive directly from the program itself or from outside parties for the restricted use in a particular program. On the statement of activities, program revenues reduce the net cost of the various functions to reflect the amount which is financed from the School District's general revenues.

The School District's most significant program revenues are Title I, At-Risk and School Lunch Program, which are reported as operating grants and contributions.

Spending Policy

The School District's policy is to apply restricted revenues first when an expense is incurred for purposes when both restricted and unrestricted net assets are available.

Encumbrance Accounting

The School District formally records encumbrances in the accounting records during the year as a normal practice. In accordance with generally accepted accounting principles, outstanding encumbrances at year-end for which goods or services are received are reclassified as expenditures and accounts payable. All other encumbrances in the annual budgeted funds are reversed at year-end and are either canceled or are included as reappropriations of fund balance for the subsequent year.

NOTES TO FINANCIAL STATEMENTS - Continued

Allocation of Expenses

The School District reports each function's direct expenses, those that are specifically associated with a service, program or department and, thus, are clearly identifiable to a particular function.

The School District has elected to not allocate indirect expenses.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements, in conformity with generally accepted accounting principles, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual amounts could differ from those estimates.

NOTE B - BUDGETARY POLICY AND PRACTICE

Excess of Expenditures Over Appropriations in Budgeted Funds

Michigan Public Act 621 of 1978 provides that a local unit shall not incur expenditures in excess of the amounts appropriated. During the year ended June 30, 2006, the School District was out of compliance with the Act as follows:

	<u>Budget</u>	<u>Actual</u>	<u>Variance</u>
General Fund			
Instruction	\$ 9,973,016	\$10,048,293	\$ (75,277)
Supporting Services	5,996,175	6,040,688	(44,513)

NOTE C - CASH AND INVESTMENTS

At June 30, 2006, the School District's cash and investments include the following:

	<u>Cash and Equivalents</u>
Cash on hand	\$ 104
Bank deposits	<u>1,532,992</u>
	<u><u>\$ 1,533,096</u></u>

NOTES TO FINANCIAL STATEMENTS - Continued

Bank Deposits

All of the School District's bank deposits are with financial institutions which provide FDIC insurance coverage.

As of June 30, 2006, \$1,643,889 of the School District's bank balance of \$1,957,601 was exposed to custodial credit risk because it was uninsured and uncollateralized.

NOTE D - RECEIVABLES, UNCOLLECTIBLE ACCOUNTS AND DEFERRED REVENUE

Property Taxes Receivable, Deferred Revenue and Property Tax Calendar

Property taxes are levied, billed and attached as enforceable liens in July and December of the School District's fiscal year. Townships within the School District collect and remit taxes until February 15, at which time the uncollected real property taxes are turned over to the counties as delinquent. Delinquent real property taxes are funded by the county and remitted to the School District. Delinquent personal property tax remains a receivable until collected from the taxpayer by the townships and remitted to the School District. In the governmental fund financial statements, if delinquent taxes are not paid within 60 days of year-end, they are recorded as deferred revenue. In the government-wide financial statements, property taxes receivable and related revenue include all amounts due the School District regardless of when cash is received. Over time, substantially all property taxes are collected.

During the fiscal year, \$18 per \$1,000 of equalized non-homestead property value of \$301 million was levied for general operating purposes. For debt service purposes, \$1.51 per \$1,000 of equalized homestead and non-homestead property value of \$586 million was levied for bonded debt repayments by the Debt Service Fund.

Intergovernmental Receivables and Deferred Revenue

Intergovernmental receivables are primarily comprised of amounts due from the State and Federal governments. Revenue is recorded as earned when eligibility requirements are met. Grant revenues deferred in the governmental fund financial statements include unearned revenue and revenue received more than 60 days following year-end (unavailable to pay liabilities of the current period). Deferred revenue received after 60 days is fully recognized as revenue in the government-wide statements if grantor eligibility requirements are met.

Amounts due from other governments at June 30, 2006 are as follows:

Due from the State of Michigan	
State Aid	\$ 1,666,151
Other receivables	42,184
Due from Federal Grants	<u>224,885</u>
	<u><u>\$ 1,933,220</u></u>

NOTES TO FINANCIAL STATEMENTS - Continued

NOTE E - INVESTMENTS IN CAPITAL ASSETS

Investments in capital assets consist of the following:

	<u>June 30, 2005</u>	<u>Additions</u>	<u>Retirements</u>	<u>June 30, 2006</u>
Buildings and improvements	\$ 15,173,102	\$ -	\$ -	\$ 15,173,102
Furniture and equipment	878,870	42,131	-	921,001
Buses and vehicles	<u>1,692,200</u>	<u>74,125</u>	<u>(105,738)</u>	<u>1,660,587</u>
Total depreciable assets	17,744,172	116,256	(105,738)	17,754,690
Less accumulated depreciation	(6,764,256)	(462,535)	105,738	(7,121,053)
Land	<u>53,441</u>	<u>-</u>	<u>-</u>	<u>53,441</u>
Total capital assets, net	<u>\$ 11,033,357</u>	<u>\$ (346,279)</u>	<u>\$ -</u>	<u>\$ 10,687,078</u>

Depreciation expense was charged to the function in the statement of activities, as follows:

Unallocated	<u>\$ (462,535)</u>
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NOTE F - STATE AID ANTICIPATION NOTE PAYABLE

The State aid anticipation note bears interest at 2.87% and is due July 21, 2006.

NOTE G - LONG-TERM LIABILITIES

Changes in long-term debt during the year ended June 30, 2006 were as follows:

	<u>Beginning Balance</u>	<u>New Debt</u>	<u>Payments/ Defeasance</u>	<u>Ending Balance</u>	<u>Current Portion</u>
General obligation bonds	\$11,174,977	\$ -	\$ (493,760)	\$10,681,217	\$ 486,901
Unaccreted premium	89,975	-	(9,516)	80,459	9,516
Unamortized refinancing costs	(384,595)	-	27,802	(356,793)	(27,802)
Accumulated leave liability	<u>217,235</u>	<u>3,661</u>	<u>-</u>	<u>220,896</u>	<u>-</u>
Long-term debt at June 30, 2006	<u>\$11,097,592</u>	<u>\$ 3,661</u>	<u>\$ (475,474)</u>	<u>\$10,625,779</u>	<u>\$ 468,615</u>

Payments on general obligation bonds are made by the Debt Service Fund. The accumulated leave liability will be liquidated primarily by the General Fund.

NOTES TO FINANCIAL STATEMENTS - Continued

At June 30, 2006, the School District's long-term debt consisted of the following:

\$1,295,000 1999 School District refunding general obligation bonds for the advance refunding of the School District's 1992 bond issue; due in annual installments of \$165,000 to \$190,000 through May 1, 2011; interest rate of 3.25% to 4.5%.	\$ 950,000
\$1,820,000 1999 Building and Site Bonds for erecting, furnishing, equipping and remodeling of Betsie Valley Elementary School and the Junior/Senior High School complex; due in annual installments of \$185,000 to \$390,000; interest rate of 4.5% to 5%.	1,430,000
\$8,260,000 2005 School District refunding general obligation bonds for the advance refunding of the School District's 1999 bond issue; due in annual installments of \$55,000 to \$1,145,000 through May 1, 2019; interest rate of 3.0% to 4.15%.	8,205,000
1998 School Improvement Bond (Durant); due in installments of \$29,372 to \$16,484 through May 15, 2013; average interest rate of 4.76%. This debt will be repaid using revenues provided by the State of Michigan specifically for this purpose. If the Michigan Legislature fails to appropriate funds, the School District is not liable for repayment of these bonds.	<u>96,217</u>
Total general obligation bonds payable	10,681,217
Unamortized refinancing costs	(356,793)
Unaccreted premium	80,459
Accumulated leave liability	<u>220,896</u>
Total long-term debt	<u><u>\$10,625,779</u></u>

NOTES TO FINANCIAL STATEMENTS - Continued

Total annual requirements to amortize bonds outstanding as of June 30, 2006 are as follows:

<u>Years Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 486,901	\$ 442,189
2008	542,471	421,253
2009	598,065	397,419
2010	658,686	370,783
2011	719,338	341,003
2012-2016	4,385,756	1,223,113
2017-2021	<u>3,290,000</u>	<u>275,076</u>
	<u>\$ 10,681,217</u>	<u>\$ 3,470,836</u>

Accumulated Leave Liability

Employees of the School District accumulate days of compensated sick leave, as specified by the bargaining units' contract. This benefit vests after 10 years of employment. Upon either resignation or retirement, the employees are compensated at daily rates specified in the bargaining units' contracts.

Prior Year Defeasance of Debt - General Obligation Bonds

On February 23, 1999, the School District issued \$1.79 million in obligation bonds with an average interest rate of 4.3% to advance refund \$1.65 million of outstanding 1992 general obligation bonds with an average interest rate of 6.5%. The net proceeds of \$1,737,738 (after payment of \$52,262 in underwriting fees, insurance and other issuance costs) were used to purchase U.S. government securities. Those securities were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the refunded portion of the 1992 general obligation bonds. The outstanding principal of the defeated bonds is \$1.2 million at June 30, 2006.

Durant Settlement

As a result of the Durant v State of Michigan settlement regarding State underfunding of school revenues, the School District will be receiving \$23,475 per year over a ten-year period beginning November 15, 1998. This represents 50% of the expected funds. For the remaining 50% of the funds from this settlement, or \$234,754, the School District has opted to participate in a bonding program enabling it to receive a lump-sum payment on November 15, 1998. The debt will be repaid over a 15-year period beginning May 15, 1999, using revenues provided by the State specifically for this purpose.

As part of the Executive Budget Recommendation for fiscal year 2004, the State refunded the bonds. The refunding changes the payment schedule without changing the total payments. There will be no debt service payments for fiscal years 2004 and 2005. Payments resumed in 2006 in the amount of \$77,794.

NOTE H - RISK MANAGEMENT

The School District is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees; unemployment benefits; and natural disasters. The School District manages its risk exposures and provides certain employee benefits through a combination of self-insurance and risk management pools.

The School District pays unemployment claims on a reimbursement basis through the Bureau of Workers' and Unemployment Compensation ("BWUC"). As BWUC pays eligible recipients benefits, this amount is billed to Benzie County Central School District. At June 30, 2006, there were no significant unbilled claims.

The School District participates in SET-SEG's risk management pools for worker's compensation claims, liability insurance and errors and omissions coverages. SET-SEG was established pursuant to laws of the State of Michigan which authorize local units of government to jointly exercise any power, privilege or authority which each might exercise separately. The purpose of SET-SEG is to provide cooperative and comprehensive risk financing and risk control services. SET-SEG provides risk management, underwriting, reinsurance and claim review, and processing services for all member governments pursuant to its charter.

The School District makes annual contributions to SET-SEG based on actuarial studies using historical data and insurance industry statistics. These contributions are paid from the General Fund. Such contributions as received by SET-SEG are allocated between its General and Member Retention Funds. Economic resources in SET-SEG's General Fund are expended for reinsurance coverage, claim payments and certain general and administrative costs, whereas resources in the Member Retention Fund are used for loss payments and defense costs up to the member's self-insurance retention limits along with certain other member-specific costs. Any refunds from SET-SEG are deposited in the School District's General Fund.

NOTE I - BALANCES AND TRANSFERS/PAYMENTS WITHIN THE REPORTING ENTITY

Receivables and Payables

Outstanding balances between funds reported as "due to/from other funds" include outstanding charges by one fund to another for services or goods, subsidy commitments outstanding at year-end, and other miscellaneous receivables/payables between funds.

<u>Fund</u>	<u>Interfund Receivable</u>	<u>Interfund Payable</u>
General Fund	\$ 126,569	\$ 6,254
Food Service Fund	6,254	76,394
Athletics Fund	-	50,175
	<u>\$ 132,823</u>	<u>\$ 132,823</u>

NOTES TO FINANCIAL STATEMENTS - Continued

Transfers and Payments

Transfers and payments within the reporting entity are substantially for the purposes of subsidizing operating functions, funding capital projects and asset acquisitions or maintaining debt service on a routine basis. Resources are accumulated in a fund to support and simplify the administration of various projects or programs.

The government-wide statement of activities eliminates transfers as reported within the segregated governmental and business-type activities columns. Only transfers between the two columns appear in this statement.

The following schedule reports transfers and payments within the reporting entity:

<u>Transfer in</u>	<u>Amount</u>	<u>Transfer out</u>	<u>Amount</u>
Other Governmental Funds		Major Governmental Funds	
Athletic Fund	\$ 190,629	General Fund	\$ 327,664
Food Service Fund	137,035	Other Governmental Funds	
'05 Refunding Bond		'99 Building & Site	
Fund	<u>190,429</u>	Bond Fund	<u>190,429</u>
	<u>\$ 518,093</u>		<u>\$ 518,093</u>

NOTE J - PENSION PLAN

The School District contributes to the Michigan Public School Employees' Retirement Systems ("MPSERS"), a cost-sharing multiple-employer defined benefit pension plan administered by the State of Michigan, Department of Management & Budget ("DMB"). MPSERS provides retirement, disability, death and post-employment health benefits to plan members and beneficiaries. Member Investment Plan ("MIP") participants receive enhanced benefits compared to Basic Plan participants. Benefits are safeguarded by Article IX, Section 24 of the Michigan Constitution. Public Act 300 of 1980, as amended, assigns authority to establish and amend benefit provisions to the State Legislature. MPSERS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to MPSERS, P.O. Box 30171, Lansing, MI 48909-7671, or by calling (517) 322-5103 or on the State of Michigan's website at www.Michigan.gov.

NOTES TO FINANCIAL STATEMENTS - Continued

Funding Policy

Plan members who participate in MIP are required to contribute 3% to 4.5% of their annual covered salary; plan members who participate in the Basic Plan may not contribute to the Plan; and Benzie County Central School District is required to contribute at an actuarially determined rate. The rate was 14.87% for the period July 1, 2005 to September 30, 2005 and 16.34% for the period October 1, 2005 to June 30, 2006 of annual covered payroll. The contribution requirements of plan members and the School District are established and may be amended by the State Legislature. The School District's contributions to MPSERS for the years ended June 30, 2006, 2005 and 2004 were \$1,476,630, \$1,283,827 and \$1,123,719, respectively, which is equal to the required contribution for each year.

NOTE K - COMMITMENTS AND CONTINGENCIES

Federal and State Grants

In the normal course of operations, the School District receives grant funds from various Federal and State agencies. The grant programs are subject to audit by agents of the granting authorities, the purpose of which is to ensure compliance with conditions precedent to the granting of funds. Any liability for reimbursement which may arise as the result of these audits is not believed to be material.

Collectively Bargained Employment Agreements

The teachers of the School District are organized under the Benzie County Central School District Education Association. The Board of Education and the Benzie County Central School District Education Association have a contract for the years ending June 30, 2005 through June 30, 2007.

The support personnel at the School District are organized under the Northern Michigan Education Association. The Board of Education and the Northern Michigan Education Association have a contract for August 1, 2003 through August 1, 2008.

The Food Service personnel at the School District are organized under the Bakery, Confectionery Tobacco Workers & Grain Millers, Local 81 ("BCTGM-Local 81"). The Board of Education and the BCTGM-Local 81 have a contract for August 1, 2003 through August 1, 2008.

NOTE L - SUBSEQUENT EVENT

The School District borrowed \$2.5 million subsequent to June 30, 2006. The note, plus interest, will be due July, 2007 and is secured by fiscal year 2006 - 2007 State aid.

REQUIRED SUPPLEMENTARY INFORMATION

Benzie County Central School District

BUDGETARY COMPARISON SCHEDULE FOR THE GENERAL FUND

Year Ended June 30, 2006

	Budgeted Amounts		Actual (GAAP Basis)	Variances - Positive (Negative)	
	Original	Final		Original to Final	Final to Actual Total
Revenues					
Local and intermediate sources	\$ 5,561,732	\$ 5,606,850	\$ 5,418,449	\$ 45,118	\$ (188,401)
State revenues	8,945,267	9,270,160	9,270,160	324,893	-
Federal revenues	621,208	607,042	616,752	(14,166)	9,710
Other	<u>445,005</u>	<u>527,238</u>	<u>719,120</u>	<u>82,233</u>	<u>191,882</u>
Total revenues	<u>15,573,212</u>	<u>16,011,290</u>	<u>16,024,481</u>	<u>438,078</u>	<u>13,191</u>
Expenditures					
Instruction	9,904,088	9,973,016	10,048,293	(68,928)	(75,277)
Supporting Services	5,764,156	5,996,175	6,040,688	(232,019)	(44,513)
Community Services	48,406	57,689	57,686	(9,283)	3
Other	<u>68,863</u>	<u>85,418</u>	<u>11,153</u>	<u>(16,555)</u>	<u>74,265</u>
Total expenditures	<u>15,785,513</u>	<u>16,112,298</u>	<u>16,157,820</u>	<u>(326,785)</u>	<u>(45,522)</u>
REVENUES OVER (UNDER) EXPENDITURES	<u>(212,301)</u>	<u>(101,008)</u>	<u>(133,339)</u>	<u>111,293</u>	<u>(32,331)</u>
Other financing sources (uses)					
Operating transfers out	<u>(296,565)</u>	<u>(327,664)</u>	<u>(327,664)</u>	<u>(31,099)</u>	<u>-</u>
REVENUE OVER (UNDER) EXPENDITURES AND OTHER FINANCING SOURCES (USES)	(508,866)	(428,672)	(461,003)	80,194	(32,331)
Fund balance, beginning of year	<u>2,166,081</u>	<u>2,166,081</u>	<u>2,166,081</u>	<u>-</u>	<u>-</u>
Fund balance, end of year	<u>\$ 1,657,215</u>	<u>\$ 1,737,409</u>	<u>\$ 1,705,078</u>	<u>\$ 80,194</u>	<u>\$ (32,331)</u>

**COMBINING FINANCIAL STATEMENTS OF
NON-MAJOR GOVERNMENTAL FUNDS**

Benzie County Central School District

COMBINING BALANCE SHEET - NON-MAJOR GOVERNMENTAL FUNDS

June 30, 2006

	<u>Special Revenue Funds</u>		<u>Debt Service Funds</u>				
			1999	1998	2005	1999	Total
	<u>Food Service</u>	<u>Athletic</u>	<u>Refunding Bond Issue</u>	<u>Durant Bond</u>	<u>Refunding Bond</u>	<u>Building and Site Bond</u>	<u>Non-Major Governmental</u>
ASSETS							
Cash and cash equivalents	\$ 92,685	\$ 49,731	\$ 40,967	\$ -	\$ 190,746	\$ 64,449	\$ 438,578
Taxes receivable	-	444	-	-	-	-	444
Accounts receivables	6,027	-	-	-	-	-	6,027
Due from other funds	6,254	-	-	-	-	-	6,254
Inventory	<u>7,688</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>7,688</u>
Total assets	<u>\$ 112,654</u>	<u>\$ 50,175</u>	<u>\$ 40,967</u>	<u>\$ -</u>	<u>\$ 190,746</u>	<u>\$ 64,449</u>	<u>\$ 458,991</u>
LIABILITIES AND FUND BALANCES							
LIABILITIES							
Accounts payable and accrued expenses	\$ 31,284	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 31,284
Due to other funds	<u>76,394</u>	<u>50,175</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>126,569</u>
Total liabilities	<u>107,678</u>	<u>50,175</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>157,853</u>
FUND BALANCES							
Reserved for debt retirement	-	-	40,967	-	190,746	64,449	296,162
Reserved for school-based activities	<u>4,976</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>4,976</u>
Total fund balances	<u>4,976</u>	<u>-</u>	<u>40,967</u>	<u>-</u>	<u>190,746</u>	<u>64,449</u>	<u>301,138</u>
Total liabilities and fund balances	<u>\$ 112,654</u>	<u>\$ 50,175</u>	<u>\$ 40,967</u>	<u>\$ -</u>	<u>\$ 190,746</u>	<u>\$ 64,449</u>	<u>\$ 458,991</u>

Benzie County Central School District

COMBINING STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES - NON-MAJOR GOVERNMENTAL FUNDS

Year Ended June 30, 2006

	Special Revenue Funds		Debt Service Funds					Total Non-Major Governmental
	Food Service	Athletic	1999 Refunding Bond Issue	1998 Durant Bond	2005 Refunding Bond	1999 Building and Site Bond	Total	
Revenues								
Property taxes	\$ -	\$ -	\$ 230,906	\$ -	\$ 378,968	\$ 284,226	\$ 894,100	\$ 894,100
Interest	1,724	951	1,155	-	2,683	1,668	5,506	8,181
State revenues	56,431	-	-	77,793	-	-	77,793	134,224
Federal revenues	348,912	-	-	-	-	-	-	348,912
Other	263,239	69,968	-	-	3,266	-	3,266	336,473
Total revenues	670,306	70,919	232,061	77,793	384,917	285,894	980,665	1,721,890
Expenditures								
Food Service	785,299	-	-	-	-	-	-	785,299
Athletic	-	228,522	-	-	-	-	-	228,522
Debt Service								
Principal	-	-	180,000	53,760	55,000	205,000	493,760	493,760
Interest	-	-	48,535	24,033	329,600	76,825	478,993	478,993
Capital outlay	22,037	33,026	-	-	-	-	-	55,063
Total expenditures	807,336	261,548	228,535	77,793	384,600	281,825	972,753	2,041,637
REVENUES OVER (UNDER) EXPENDITURES	(137,030)	(190,629)	3,526	-	317	4,069	7,912	(319,747)
Other financing sources (uses)								
Operating transfers in	137,035	190,629	-	-	190,429	-	190,429	518,093
Operating transfers out	-	-	-	-	-	(190,429)	(190,429)	(190,429)
Total other financing sources (uses)	137,035	190,629	-	-	190,429	(190,429)	-	327,664
REVENUE OVER (UNDER) EXPENDITURES AND OTHER FINANCING SOURCES (USES)	5	-	3,526	-	190,746	(186,360)	7,912	7,917
Fund balance, beginning of year	4,971	-	37,441	-	-	250,809	288,250	293,221
Fund balance, end of year	\$ 4,976	\$ -	\$ 40,967	\$ -	\$ 190,746	\$ 64,449	\$ 296,162	\$ 301,138

FEDERAL PROGRAMS

Benzie County Central School District

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Year Ended June 30, 2006

Federal Grantor/ Pass-Through Grantor Program Title	CFDA Number	Original Approved Award/Grant Amount	Accrued Revenue June 30, 2005	Prior Year Expenditures	Current Year Receipts	Current Year Expenditures	Accrued Revenue June 30, 2006
United States Department of Education							
Passed through Michigan Department of Education							
Title I Grants - Educationally Deprived	84.010						
041530-0405		\$ 50,954	\$ -	\$ 50,955	\$ -	\$ -	\$ -
051530-0405		404,946	97,808	357,780	97,808	-	-
051530-0506		47,166	-	-	47,166	47,166	-
061530-0506		404,946	-	-	213,599	401,913	188,314
Total Title I Grants - Educationally Deprived		<u>908,012</u>	<u>97,808</u>	<u>408,735</u>	<u>358,573</u>	<u>449,079</u>	<u>188,314</u>
Title V - Innovation Educational Program Strategies	84.298						
050250-0405		16,962	-	16,962	-	-	-
060250-0506		11,144	-	-	11,144	11,144	-
Total Innovation Educational Program Strategies		28,106	-	16,962	11,144	11,144	-
Title IIA - Improving Teacher Quality	84.367						
050520-0405		112,493	19,080	109,591	19,080	-	-
050520-0506		2,902	-	-	2,902	2,902	-
060520-0506		108,679	-	-	72,108	108,679	36,571
Total Improving Teacher Quality		<u>224,074</u>	<u>19,080</u>	<u>109,591</u>	<u>94,090</u>	<u>111,581</u>	<u>36,571</u>
Safe and Drug-Free Schools and Communities	84.186						
052860-0405		12,303	-	12,303	-	-	-
062860-0506		12,556	-	-	12,556	12,556	-
Total Safe and Drug-Free Schools and Communities		24,859	-	12,303	12,556	12,556	-
Technology Literacy Challenge Grants	84.318						
044290-0405		3,293	-	3,293	-	-	-
054290-0405		10,291	90	8,146	90	-	-
054290-0506		2,145	-	-	2,145	2,145	-
064290-0506		7,554	-	-	7,554	7,554	-
Total Technology Literacy Challenge Grants		<u>23,283</u>	<u>90</u>	<u>11,439</u>	<u>9,789</u>	<u>9,699</u>	<u>-</u>
Total Passed Through Michigan Department of Education		<u>1,208,334</u>	<u>116,978</u>	<u>559,030</u>	<u>486,152</u>	<u>594,059</u>	<u>224,885</u>

Passed through Traverse Bay Area ISD									
Preschool	84.027A								
050460-0405		\$ 15,813	\$ -	\$ 15,813	\$ -	\$ -	\$ -		
060450-0506		1,041	-	-	1,041	1,041	-		
060460-0506		12,984	-	-	12,984	12,984	-		
Total Goals 2001		29,838	-	15,813	14,025	14,025	-		
Capacity Building Grant	84.027A								
03/04		17,706	-	3,600	-	-	-		
Total Passed Through Traverse Bay Area ISD		47,544	-	19,413	14,025	14,025	-		
Total U.S. Department of Education		1,255,878	116,978	578,443	500,177	608,084	224,885		
Michigan State Police Department									
Homeland Security Grant	97.004								
2003		8,668	-	-	8,668	8,668	-		
2004		15,169	-	15,169	-	-	-		
Total Homeland Security Grant		23,837	-	15,169	8,668	8,668	-		
United States Department of Agriculture									
Nutrition Cluster									
Passed Through Michigan Department of Education									
National School Lunch Program									
1950 All Lunches	10.555	-	-	46,023	37,263	37,263	-		
1960 Free and Reduced	10.555	-	14,228	173,889	219,980	205,752	-		
1970 Breakfast	10.553	-	-	76,650	69,924	69,924	-		
Total Nutrition Cluster		-	14,228	296,562	327,167	312,939	-		
USDA Commodities									
Bonus	10.550	-	-	8,411	3,968	3,968	-		
Entitlement	10.550	-	-	27,625	32,005	32,005	-		
Total Passed Through Michigan Department of Education		-	-	36,036	35,973	35,973	-		
Total U.S. Department of Agriculture		-	14,228	332,598	363,140	348,912	-		
United States Department of Health and Human Services									
Passed Through Traverse Bay Area ISD									
Medicaid - School Based Services	93.778	-	-	10,130	-	-	-		
Total Passed Through Traverse Bay Area ISD		-	-	10,130	-	-	-		
Total U.S. Department of Health and Human Services		-	-	10,130	-	-	-		
Total Federal Financial Assistance		\$ 1,279,715	\$ 131,206	\$ 936,340	\$ 871,985	\$ 965,664	\$ 224,885		

Benzie County Central School District

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

June 30, 2006

- Note 1** The Schedule of Expenditures of Federal Awards is prepared using the modified accrual basis of accounting.
- Note 2** Management has reported that expenditures in this Schedule of Expenditures of Federal Awards are equal to those amounts reported in the annual or final cost reports. Unallowed differences, if any, have been disclosed to the auditor.
- Note 3** The financial reports, including claims for advances and reimbursements and amounts claimed or used for matching are timely, complete, accurate and contain information that is supported by the books and records from which the basic financial statements have been prepared. Grant receipts reported on the Schedule of Expenditures of Federal Awards, as passed through the Michigan Department of Education, reconcile to the Grant Section Auditor's Report (R7120). Unreconciled differences have been disclosed to the auditor.
- Note 4** A reconciliation of expenditures on the Schedule of Expenditures of Federal Awards with Federal sources reported on the financial statements are as follows:

Federal expenditures per Schedule of Expenditures of Federal Awards	\$ <u>965,664</u>
Federal sources per financial statements	\$ <u>965,664</u>



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**REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER
FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

Board of Education
Benzie County Central School District

We have audited the financial statements of the governmental activities, each major fund and the aggregate remaining fund information of ***Benzie County Central School District*** (the "School District") as of and for the year ended June 30, 2006, which collectively comprise the School District's basic financial statements and have issued our report thereon dated August 3, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the School District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance

As part of obtaining reasonable assurance about whether the School District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Education, management, Michigan Department of Education, Federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Dennis, Gartland & Niergarth

August 3, 2006



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REPORT OF COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

Board of Education
Benzie County Central School District

Compliance

We have audited the compliance of ***Benzie County Central School District*** (the "School District") with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each of its major Federal programs for the year ended June 30, 2006. The School District's major Federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major Federal programs is the responsibility of the School District's management. Our responsibility is to express an opinion on the School District's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major Federal program occurred. An audit includes examining, on a test basis, evidence about the School District's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the School District's compliance with those requirements.

In our opinion, Benzie County Central School District complied, in all material respects, with the requirements referred to above that are applicable to each of its major Federal programs for the year ended June 30, 2006.

Internal Control Over Compliance

The management of the School District is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to Federal programs. In planning and performing our audit, we considered the School District's internal control over compliance with requirements that could have a direct and material effect on a major Federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants caused by error or fraud that would be material in relation to a major Federal program being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Board of Education, management, Michigan Department of Education, Federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Dennis, Gartland & Niergarth

August 3, 2006

Benzie County Central School District

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

June 30, 2006

PRIOR YEAR

No findings.

CURRENT YEAR

Section 1 - Summary of Auditors' Results

1. The auditor's report represents an unqualified opinion on the general purpose financial statements of Benzie County Central School District.
2. The auditor's report does not disclose any reportable conditions in internal control as a result of the audit of the financial statements.
3. There were no compliance findings disclosed that were material to the School District's financial statements.
4. The auditor's report does not disclose any reportable conditions in internal control over major programs.
5. The report over compliance for major programs was unqualified.
6. There were no audit findings relative to major programs that are required to be reported.
7. The School District's major program was the Nutrition Cluster.
8. The dollar threshold for distinguishing between Type A and Type B programs was \$300,000.
9. Benzie County Central School District qualified as a low risk auditee.

Section 2 - Findings in Accordance with Governmental Auditing Standards

No findings.

Section 3 - Findings and Questioned Costs in Accordance with OMB Circular A-133

No findings or questioned costs.



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AUDIT-RELATED COMMUNICATIONS

To the Board of Education
Benzie County Central School District

We have audited the financial statements of ***Benzie County Central School District*** (the "School District") for the year ended June 30, 2006, and have issued our report thereon dated August 3, 2006. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under U.S. Generally Accepted Auditing Standards

As stated in our engagement letter dated June 30, 2005, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement and are fairly presented in accordance with U.S. generally accepted accounting principles. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

In planning and performing our audit, we considered the School District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. We also considered internal control over compliance with requirements that could have a direct and material effect on a major Federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

As part of obtaining reasonable assurance about whether the School District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit. Also, in accordance with OMB Circular A-133, we examined, on a test basis, evidence about the School District's compliance with the types of compliance requirements described in the U.S. Office of Management and Budget ("OMB") Circular A-133 Compliance Supplement applicable to each of its major Federal programs for the purpose of expressing an opinion on the School District's compliance with those requirements. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on the School District's compliance with those requirements.

As part of our audit, we considered the internal control of the School District. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control. However, we offer the following comments and recommendations for your consideration.

Segregation of Duties

We remind you that an inherent weakness in your system of internal control exists because the limited size of your staff does not permit an adequate segregation of duties. Without an adequate segregation of duties, there is an increased risk that errors or fraud could occur and not be detected. We can provide consulting services to help you identify your greatest risk exposures and design procedures to reduce those risks to the extent reasonably possible.

Significant Accounting Policies

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the School District are described in Note A to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2006. We noted no transactions entered into by the School District during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. During the audit, we evaluated management's estimates against available information as a basis for concluding about the reasonableness of these estimates. However, we do not consider such estimates to be particularly sensitive.

Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the School District's financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, none of the adjustments we proposed, whether recorded or unrecorded by the School District, either individually or in the aggregate, indicate matters that could have a significant effect on the School District's financial reporting process.

Recorded Adjustments

We proposed an entry to recognize prior year deferred revenue.

We proposed an entry to adjust state aid note to actual.

We proposed an entry to record Durant debt service.

Unrecorded Adjustments

We identified various differences between actual and recorded revenue which both we and the School District management concluded were immaterial to the financial statements.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Issues Discussed Prior to Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the School District's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing our audit.

Hot Topics in Education Finance

Hot Lunch Point-of-Sale System

Our tests of hot lunch revenue indicate the point-of-sale system may not be accumulating meal counts correctly. The District relies on the accuracy of information produced by the point-of-sale system for Federal funding, so accurate information is crucial in these times of tight budgets. We understand management is currently monitoring the hot lunch point-of-sale system.

Summer Tax Collection

Many districts are gradually shifting the school portion of property tax bills to 100% collection in the summer rather than splitting collection between summer and winter. The benefit of this shift to the school district is that districts can receive their property tax revenue earlier in the year and invest it to earn additional revenue. Most districts making this shift are doing so gradually over a number of years to make the shift less noticeable to taxpayers.

Time and Effort Reporting Requirements

The recently published Michigan Department of Education Accounting and Auditing alert highlights the importance of proper time and effort reporting in relation to Federal programs. We recommend that the School District and Board review these requirements and that your internal documentation requirements be reviewed for compliance with OMB Circular A-87. Proper documentation will help prevent any future potential charge-backs for Federal funds.

Budget Deficits and the Uniform Budgeting and Accounting Act

The Michigan Department of Education has recently announced its intention to closely monitor districts that appear to be in violation of the Uniform Budgeting and Accounting Act. This act requires that school districts not incur expenditures in excess of budgets or operate with a deficit budget. In the extreme case, the attorney general could take action against a school and its board members were a deficit budget to be enacted. This issue is being monitored by the Department of Education, and correspondence will be issued when violations of the act are detected.

Hay Group Report on the Michigan Public School Health System

A recently released report by the Hay Group gives the opinion that approximately \$280 million could be saved if Michigan were to abandon its Michigan Educational Special Services Association ("MESSA") health coverage and implement a state-wide health benefit system for public school employees. All organizations will face issues with funding health care coverage in the future and schools will be especially hard hit because school funding is not increasing at a pace to offset projected medical cost increases. MESSA has commissioned a study by Reden & Anders Ltd. to analyze the Hay report and determine if the projected savings are real. This report was recently released and points out some concerns with the methodology. There is currently legislation pending regarding this issue.

The 65% Solution

The 65% solution is a school spending philosophy that has taken hold recently in a number of states. The basic premise of the philosophy is that by requiring a school to spend 65% or more of a district's budget directly in the classroom, school performance will improve and excessive overhead costs will be squeezed out. Proponents of this program site statistics that show the top performing schools spend over 64% of their budgets directly in the classroom, while the lowest performing schools spend as little as 49% in the classroom. Opponents to the philosophy say it depends on how you measure and what is considered as classroom spending. Opponents also say it is backed mostly by voucher and charter school supporters as a tactic to help voucher legislation get passed in more states. Legislation has been passed in 2 states regarding this and 10 others have some sort of proposal in process.

Using an Internal Service Fund to Account for Early Retirement Incentives

GASB Statement No. 47, which was released in 2005 is a new accounting pronouncement related to Early Retirement Incentives ("ERI"). Statement No. 47 requires recognition of the cost of involuntary termination benefits in the period in which a government becomes obligated to provide benefits to terminated employees, which is not necessarily the same period as when the benefits are actually provided. The statement requires recognition of the cost of voluntary termination benefits when the termination offer is accepted. This can be a significant liability to a school district and should be planned for accordingly. Some districts have established internal service funds to account for ERI. One benefit to this approach is the internal service fund isolates the activity for monitoring the impact. Internal Service Funds can also be used to account for other long-term liabilities, such as self insurance, severance pay accruals, and compensated absence accruals. Bus fleet activity and other similar pooled activities can be accounted for in an internal service fund as well. We would be happy to discuss the pros and cons of this approach further.

Athletic, Student Activity, School Lunch and Other Internal Control Risks

At this spring's MSBO conference, one of the "red-flags" raised was the lack of proper internal controls around cash intensive areas of the school district, such as athletic tickets and school lunch. As published in regional newspapers, a school district in the Northern Michigan region was recently an unfortunate victim of a \$100,000 embezzlement incident in the school lunch area. Unfortunately, a financial audit does little to provide assurance that your school district has proper procedures in place for these and other high-risk areas.

A school district needs to conduct an ongoing evaluation of its internal controls in all areas to limit its exposure. Internal controls are the policies and procedures you put in place to reduce the potential for undetected mistakes or fraud. Like most small organizations, your internal control system is inherently weakened by the absence of an adequate segregation of incompatible duties (one or a few people do everything). Everybody can make mistakes and most frauds are perpetrated by people held in a position of trust so this is an issue regardless of the qualities of the people working for you.

Internal controls are designed both to protect you from corrupt employees, customers, vendors and others and to protect honest employees from innocent mistakes and misplaced suspicions. There may be opportunities for you to reduce the risk of undetected mistakes or fraud through the implementation of a few relatively easy internal control procedures. We would be happy to work with you to identify your greatest risk exposures and offer suggestions for ways to reduce that risk with simple cost-effective procedures.

The Importance of Long-Term Planning

Recent financial issues in school districts throughout the state highlight the increased need for long-term school planning. Minimal increases in the foundation allowance along with increasing health care and retirement costs will only make the future more difficult to manage. A long-term (5 year) plan is one means for a school district to proactively manage their financial future. This is a difficult exercise in today's environment, but one that is critical if the board is to analyze the impact of various scenarios on the school's future. If you have not already done so, you should consider this process. To be most effective, this should be a group process and updated on an annual basis. These projections will be useful when undergoing contract negotiations.

Budget Fund Balance

State law mandates that school districts do not operate with a deficit budget. State law does not, however, mandate maintaining a healthy fund balance. Maintaining a minimum fund balance is only smart management of the school district's resources. A fund balance of approximately 10% of the total annual operation expense of the School District's General Fund Budget is a reasonable target fund balance. Setting a target fund balance to maintain would provide flexibility in dealing with unanticipated budget emergencies such as mid-year reductions in state funding. We commend the School District for identifying a target fund balance and adopting a Board policy. This will provide guidance and direction on an annual basis as each year's operating budget is prepared and adopted.

This information is intended solely for the use of the Board of Education and management of Benzie County Central School District and is not intended to be and should not be used by anyone other than these specified parties.

We are pleased to serve as the School District's auditors. If there are any questions about the audited financial statements or the contents of this letter, we would welcome the opportunity to discuss them at your convenience.

Dennis, Gartland & Niergarth

August 3, 2006